92-1201

Supreme Court, U.S.
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No. 92-

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1992

ARMSTRONG WORLD INDUSTRIES, INC.,

Petitioner,

v.

THE INDUSTRY NETWORK SYSTEM, INC.
AND ELLIOT FINEMAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Court should reverse the decision of the Third Circuit because it (a) ignored *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984) and other controlling precedents of the Court, and (b) thereby held, in sharp and unexplained departures from well-established law, that a single oral comment by petitioner's local sales manager to one distributor-customer ("I don't think [it] makes a lot of sense" to distribute respondent's product) could serve as the foundation for a vertical antitrust conspiracy.

2. Whether the Third Circuit erred because (a) it adopted, contrary to the Court's decisions and those of at least four other circuits, a "functionally equivalent" test in holding that the relevant "market or submarket" included only two products (respondent's monthly video magazine sold to floor covering retailers and featuring industry-wide information, and petitioner's video "selling aids" sold only to its distributors and featuring only its own products), and (b) it thereby ignored the uncontradicted fact that no consumers of those products regarded them as being reasonable substitutes.

3. Whether the Third Circuit erred in holding that the decision of one wholesaler-distributor, out of at least 450 others, not to distribute respondent's video magazine in Connecticut caused injury to competition and related antitrust injury to respondent TINS in a market stipulated to be nationwide in geographic scope.

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Petitioner Armstrong World - Industries, Inc. ("Armstrong") prays that a writ of certiorari issue to review the judgment below of the Court of Appeals for the Third Circuit. Pursuant to Rule 29.1, Armstrong has no parent company and no subsidiaries other than wholly-owned subsidiaries.

OPINIONS BELOW

The opinion of the Third Circuit is reported at _____ F.2d _____ and is included in Appendix A to this petition. 1A-93A.[1] The district court's opinion is reported at 774 F. Supp. 225 (D.N.J. 1991) and is included in Appendix B, 94A-178A; the district court entered judgment n.o.v. for Armstrong on the claims of respondent, The Industry Network System, Inc. ("TINS"), under Section 2 of the Sherman Act, 15 U.S.C. § 2, and under New Jersey tort law. The district court's oral opinion during trial, granting Armstrong's motion for a directed verdict on TINS' conspiracy claims under Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1 & 2, is included in Appendix C. 179A-183A.

JURISDICTION

The Third Circuit entered judgment on October 28, 1992, Appendix D, 184A-185A, and on November 24, 1992 denied (two judges dissenting) a timely petition for renearing and suggestion for rehearing *in banc*. Appendix E, 186A-187A. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Section 1 of the Sherman Act, 15 U.S.C. § 1, provides in pertinent part:

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[1] Citations to the Appendix to this petition will be identified with the suffix "____A;" citations to the Joint Appendix in the court of appeals will be identified with the prefix "JA____."

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.

STATEMENT OF THE CASE

This case presents important issues concerning the legal criteria to ensure that routine commercial disputes involving state law tort or contract claims are not improperly transformed into mammoth federal antitrust cases. This is a case that has already consumed months of trial time, although the purported wrongful conduct was a single comment to a distributor-customer by Armstrong's local sales manager (I "don't think [it] makes a lot of sense" to distribute respondent's product), which resulted in a jury award of antitrust and tort damages aggregating more than $235 million. It also is a case in which the court below allowed antitrust law to run amok in sharp and unexplained departures from this Court's controlling precedents.

Immediately at issue is the Third Circuit's holding that TINS is entitled to reach the jury in a second trial on its conspiracy claim under Section 1 of the Sherman Act. The theory of TINS' claim, endorsed in the decision below, is that the single oral comment of Armstrong's employee amounted to a "threat" and "coercion" forcing one Armstrong distributor (Stern & Company or "Stern") to enter into a vertical antitrust conspiracy to "eliminate" TINS from a nationwide video magazine market for floor covering retailers. According to the Third Circuit, Stern "knowingly" delivered the fatal blow merely by exercising its lawful right to cancel a Letter of Intent to become TINS' magazine sales agent in Connecticut.

1. **The Parties and Their Products.** The principal parties are Armstrong and TINS. All claims of the individual

respondent (Elliot Fineman, President of TINS) were dismissed by district court orders not disturbed on appeal.

In the relevant period of 1984, Armstrong manufactured floor covering, both carpet and resilient (sometimes called "vinyl" or "linoleum"), which it sold to wholesale distributors who in turn resold to retailers. On a non-profit basis, Armstrong provided to its distributors "selling aids" in print, slide and video tape formats, all containing information only on Armstrong's resilient floor covering. In 1984 Armstrong had nine video cassettes that were available only to distributors at a price of $20 per cassette which distributors, without imposing any charge, on occasions allowed retailers to view.[2]

TINS was formed in 1983 with an equity investment of $5,000 to publish, "exclusively for floor covering retailers," a monthly video magazine containing industry-wide news, interviews and retailer "success" stories, plus a spliced-on "distributor's tag" typically in the form of an advertisement on behalf of each local distributor selling the magazine in an assigned territory. The initial annual subscription price of $480 was increased to $540 by May 1984. TINS solicited floor covering distributors to serve as agents for selling magazine

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[2] JA3830-31, 4777-78, 7946. In 1986 Armstrong added a new video laser disc as part of an integrated franchising package of customized showroom and floor display materials for use by participating retailers known as "Floor Fashion Centers" ("FFC"). JA3857-63, 3872-74. Armstrong's laser disc videos (i) were designed for viewing by *consumers* interested in consumer-type information, whereas TINS' magazine was "geared entirely to [viewing by] Floor Covering retailers" [JA7344], and (ii) focussed exclusively on Armstrong products [JA3865-66] (the same as the earlier nine cassettes for wholesalers only), whereas TINS' magazine covered the whole flooring industry with no promotion of any particular brand of floor covering. At the time of trial, the FFC program included approximately 700 participating retailers, who represented only 3-1/2% of the 20,000 floor covering retailers who were the targeted subscribers for TINS' magazine. JA3860-61, 7344.

subscriptions to retailers. After producing only eight monthly issues beginning in December 1983 and suffering net losses of almost $740,000 by May 31, 1984, JA8000-01, TINS ceased operations in July 1984 for lack of funds. JA1775-76.

2. **The Alleged Co-Conspirator**. In 1984 Armstrong distributed its resilient floor covering through approximately 69 local wholesalers, including Stern which served the Connecticut area. TINS alleged that Stern conspired with Armstrong to commit the single act purportedly designed to "eliminate" TINS from the alleged video magazine market. Specifically, on May 24, 1984 Stern signed a "Letter of Intent" prospectively to become a TINS magazine sales agent, and four weeks later during a TINS sales training program (prior to Stern's sales of any subscriptions), Stern exercised its lawful right to cancel the Letter of Intent.[3] Four Stern witnesses confirmed that the cancellation reflected their company's independent decision with no Armstrong involvement whatsoever. JA4301, 4318-19, 4665, 5027-28, 5292. Five other Armstrong wholesalers, who either distributed TINS' magazine in 1984 or seriously considered doing so, testified without contradiction that Armstrong had no influence on their decisions regarding TINS. JA4108, 4169, 4851, 5063, 5070-71, 5074, 5167-68, 5249-50.

3. **Armstrong's Conduct**. On June 7, 1984, Stern's President, Alan Abrahamson, attended a previously arranged business conference and voluntarily mentioned the prospective TINS arrangement to two local Armstrong sales managers, Robert Guzinsky for carpet and Robert Roth for resilient. Guzinsky said that TINS "sounds like a good idea." JA4048.

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[3] As a prospective sales agency contract with no specified term, the Letter of Intent was terminable at will as a matter of law. Restatement (Second) of Agency § 118, comments a and b (1957); 2 Walter H. E. Jaeger, *Williston on Contracts*, § 279 (3d ed. 1959); *see, e.g., NLRB* v. *Marcus Trucking Co.*, 286 F.2d 583, 588 (2d Cir. 1961).

Roth's comment is found in his answer to one leading question by TINS' counsel:

> Q. Did you say to Alan [Abrahamson], I don't think this [TINS] makes a lot of *sense in the* Armstrong scheme of things, given the fact that we do have our own video program that can help you [Stern] increase your profitability, that type of thing?
>
> A. That's probably what I [Roth] said because we have an overlap program.

188A. Abrahamson immediately made clear that Roth's "overlap" perception was in fact a misconception. Abrahamson replied that, instead of being an overlap, TINS' magazine would "fill in a void" because it did something that Armstrong's videos did not do. The business conference then turned to other matters. JA4080. The pertinent portions of Roth's testimony are in Appendix F. 188A-190A. In the 29 days between Stern's signing and cancelling the Letter of Intent, these brief comments on June 7 during a routine half-day business conference were the only TINS-related communications made by Armstrong to Stern.[4]

4. **Absence of Market Impact**. This case was tried in 1991, seven years after TINS ceased operations. During that period, Armstrong's videos had no discernible impact in the

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[4] Five days after the June 7 conference, Armstrong's sales manager at corporate headquarters, who had no knowledge of either Stern's Letter of Intent or the June 7 comments, prepared a short TINS-related memo that was circulated internally within Armstrong and never communicated to Stern. This memo is included in Appendix G. 191A-192A. It advised local managers that "participation" or "assistance" by local Armstrong personnel in the TINS program on behalf of a TINS distributor would be "improper" because it would discriminate against other competing Armstrong distributors not in the TINS program.

alleged video magazine market. The Third Circuit accordingly dismissed TINS' Section 2 Sherman Act claims, because "we are left without record support to discern precisely how extensively Armstrong has penetrated the video market for retailers." 71A-72A. *The Third Circuit also determined that because* "the record clearly proves that barriers to entry in the video market are extremely low," other firms have readily "produced their own substitute video magazine," and such production substitutability effectively prevented Armstrong from having any exclusionary power "even if Armstrong remains the only supplier in the relevant video market." *Id.*

5. **Proceedings Below**. The complaint contained both state law contract and tortious interference claims as well as federal and state antitrust claims, all based on the same alleged conduct of Armstrong. The contract claim was dismissed on summary judgment before trial. At the close of TINS' trial evidence, the district court directed a verdict for Armstrong on the Sherman Act Sections 1 and 2 conspiracy claims, holding that "under no set of circumstances based on this record could the jury reasonably find that Stern shared Armstrong's [alleged] *purpose* of eliminating TINS from competition in the video magazine market." 180A (emphasis added).[5]

The jury returned a verdict for TINS on the remaining claims, awarding $19.5 million antitrust damages prior to

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[5] The Third Circuit overturned this ruling on the theory that the district court, by using the word "purpose," had erroneously required proof that Stern and Armstrong had an identical *motive*, as distinct from a shared unlawful anticompetitive *objective*. 78A-80A. But the only anticompetitive motive or objective proffered by TINS was to eliminate TINS, and the "shared purpose" required in the district court's ruling is precisely what this Court has required, *i.e.*, "a unity of *purpose* or a common design and understanding, or a meeting of minds in an unlawful arrangement." *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 764 (1984) (emphasis added, quoted citations omitted).

trebling, $17.7 million for tortious interference and $200 million as punitive damages. The district court granted Armstrong's motion for judgment n.o.v. because the "evidence, even viewed most favorably toward [TINS], is critically deficient with respect to two [essential] . . . elements: wrongful conduct and proximate cause." 130A. In the alternative, the district court granted a new trial on two independent grounds: the verdict was clearly against the weight of the evidence, and TINS' trial counsel had engaged in grossly improper conduct that prejudiced and inflamed the passions of the jury.

The Third Circuit upheld both grounds for a new trial and affirmed the judgment n.o.v. on TINS' non-conspiracy claims under Section 2 of the Sherman Act. (The directed verdict on TINS' Section 2 Sherman Act conspiracy claim was not appealed.) However, the Third Circuit reversed the directed verdict for Armstrong on TINS' Section 1 Sherman Act conspiracy claim, thus giving rise to this petition. The court of appeals also reversed summary judgment granted earlier in Armstrong's favor on the contract claim, as well as the judgment n.o.v. for Armstrong on TINS' state law claims for tortious interference and punitive damages.[6]

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[6] If TINS' Sherman Act conspiracy claim is invalidated, TINS' state law claims for tortious interference and associated punitive damages, though not the subject of this petition, are not likely to survive. The Third Circuit recognized that the inferences in Part III of its opinion on tort issues, e.g., premising a "threat" and "coercion" on Roth's statement, were the same for both the tort and antitrust claims. 79A, n.30. Moreover, if the punitive damage award had not been vacated by the new trial order, it would have been unconstitutional under *Pacific Mut. Life Ins. Co.* v. *Haslip*, 111 S. Ct. 1032 (1991).

REASONS FOR GRANTING THE WRIT

I. THE THIRD CIRCUIT'S CONSPIRACY RULING REFLECTS SHARP AND UNEXPLAINED CONFLICTS WITH THIS COURT'S CONTROLLING PRECEDENTS

Under any reasonable reading, the Third Circuit's conspiracy ruling irrationally restricts legitimate business dealings between manufacturers and their distributors, poses a clear threat to proper application of the antitrust laws, and stands in sharp and unexplained conflict with well-established law in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977); *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984); and *Matsushita Elec. Indus. Co.* v. *Zenith Radio Corp.*, 475 U.S. 574 (1986). Summary reversal is appropriate.

A. The Established Law on Vertical Conspiracies

In *Sylvania* the Court recognized that "[v]ertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." 433 U.S. at 54. For that reason, a manufacturer can "induce" its distributors "to engage in promotional activities or to provide service . . . necessary to the efficient marketing . . . and the competitiveness of [the manufacturer's] . . . product." *Id* at 55.

Building on *Sylvania*, the Court established in *Monsanto* that "manufacturers and distributors constantly must coordinate their activities to assure that their product will reach the consumer persuasively and efficiently," and that the antitrust law does not "bar a manufacturer" from such legitimate joint activities because that "would create an irrational dislocation in

the market." 465 U.S. at 763-64. *Monsanto* held that in a vertical conspiracy case the law requires "evidence sufficient to . . . prov[e] . . . an agreement," and does not allow "an inference of such an agreement . . . drawn from highly ambiguous evidence" because to do so would create "a considerable danger that the [Court's] doctrines enunciated in *Sylvania* and *Colgate* will be seriously eroded." *Id.* at 763.

To curtail such danger, *Monsanto* held that in the absence of direct evidence of a conspiratorial agreement, a vertical conspiracy must include at least two elements: (1) "There must be evidence that tends to exclude the possibility that the manufacturer and non-terminated distributors were acting independently," and (2) "evidence must be presented both that the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer." *Id.* at 764 & n. 9. The evidence must establish that the distributor and manufacturer had "a unity of purpose or a common design and understanding, or a meeting of minds in an unlawful arrangement," or stated differently, that they "had a conscious commitment to a common scheme designed to achieve an unlawful objective." *Id.* (quoted citations omitted).

In *Matsushita*, the Court reinforced *Sylvania* and *Monsanto* by holding that "antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case," and further noting that *Monsanto* "held that conduct as consistent with permissible competition as with illegal conspiracy does not, standing alone, support an inference of antitrust conspiracy." 475 U.S. at 588. *Matsushita* reaffirmed the *Monsanto* principle that conduct reflecting the "essence of competition" cannot be the basis for "mistaken inferences [which] . . . are especially costly, because they chill the very conduct the antitrust laws are designed to protect." *Id.* at 594.

B. The Third Circuit's Glaring Departures From Established Law

The Third Circuit held that a jury could properly find a vertical conspiracy to "eliminate" TINS based on three facts deemed critical: (1) Roth's statement that it "does not make a lot of sense" for Stern to distribute a perceived "overlap" product; (2) Fineman's voluntary disclosure to Armstrong six months earlier that TINS was then in a precarious financial position; and (3) Armstrong's product accounted for approximately 90% of Stern's sales. The Third Circuit's reasoning is set forth below verbatim:

> -- [First], [a]lthough the inference is broad, *Roth's "overlap" statement* could have been understood to demonstrate that Abrahamson [Stern] recognized a conflict between Armstrong's and TINS' videotapes and *recognized Armstrong's anti-competitive goal.*
>
> -- Second, Armstrong clearly benefitted from eliminating TINS' competition in the video market and *Stern benefitted from appeasing the supplier* upon whom it was so dependent.
>
> -- Third, given the evidence that *Armstrong executives knew of TINS' precarious financial position* [six months earlier], the agreement between Armstrong and Stern would have been central to the demise of TINS.
>
> -- Thus we conclude that a rational factfinder could draw the inference that Armstrong wanted to eliminate TINS from the video market . . . and that Stern knowingly aided in that effort, albeit

> from somewhat different motives.
>
> -- It is not likely that Stern believed that it was the only distributor Armstrong did not wish TINS to deal with; and a jury could find that *Stern is chargeable with knowledge* that if Armstrong succeeded, TINS would indeed be eliminated as a competitor in that market.[7]

81A-82A (emphasis added). Incredibly, the Third Circuit failed even to consider this Court's controlling precedents that condemn such an attenuated chain of inferences. Its decision rests upon the following glaring conflicts with established law on vertical conspiracies.

1. **Absence of Any Basis for Inferences of "Anti-competitive Goal," "Threat" or "Coercion."** Obviously no coerced conspiracy can exist without coercion. To find coercion here, the Third Circuit was compelled to rely on Roth's "does not make a lot of sense" comment and to hold that this single oral statement (a) was a "threat" because Armstrong's position as Stern's main supplier "made Stern particularly susceptible to coercion," 43A, (b) "could have been understood to demonstrate . . . Armstrong's anticompetitive goal," 81A, and (c) showed "that Armstrong wanted to eliminate TINS [to avoid having] . . . to compete with TINS." *Id.*

These holdings stand in sharp conflict with established law. Under *Sylvania*, manufacturers are entitled to "induce [distributors] . . . to engage in promotional activities" to

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[7] In discussing tort issues, the Third Circuit also ruled that Roth's statement was a "threat" and that Stern was "susceptible to coercion" because of Stern's "dependence" upon Armstrong as its principal supplier. 42A-43A.

enhance "the competitiveness of [the manufacturer's] product". 433 U.S. at 55. Thus, Roth's statement was clearly proper and could not be a threat because, as the Third Circuit recognized, 81A, n.31, at most it only "counseled" Stern in a manner to encourage use of Armstrong's video selling aids, which admittedly promoted Armstrong's resilient flooring with "product information, sales training and techniques." 56A.[8]

Monsanto held that "manufacturers and distributors constantly must coordinate their activities to assure that their product will reach the consumer persuasively and efficiently" and that antitrust rules cannot be invoked "[t]o bar a manufacturer" from engaging in business conduct consistent with legitimate competition. 465 U.S. at 763-64. *Matsushita* reinforced the principle that conduct reflecting the "essence of competition" cannot support the inference of an antitrust conspiracy. 475 U.S. at 594. Apart from Guzinsky's comment terming TINS a "good idea," Armstrong's *only* mention of TINS to Stern was Roth's statement as a salesman — that it "did not make a lot of sense" for Stern to distribute a perceived "overlap" product. This is the "essence of competition" expressly protected by *Matsushita*. The Third Circuit provided no explanation for its holdings exactly opposite to the Court's

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[8] The district court held that "[n]o jury could reasonably infer from this [Roth] statement that Armstrong acted with any level of malice or intent to harm" because "the statement is not itself a threat, does not suggest a threat, and did not take place in a context suggesting a threat." 134A. The district court therefore ruled that Armstrong's actions did not rise to the level of being a proximate cause for that decision [of Stern] . . . and no reasonable juror could conclude otherwise." 145A. Other circuits, which have faithfully followed this Court's precedents, hold that a coerced vertical conspiracy cannot be inferred from the manufacturer's dealings with a distributor involving "exposition, persuasion, argument or pressure." *See, e.g., Jeanery, Inc.* v. *James Jeans, Inc.*, 849 F.2d 1148, 1158-59 (9th Cir. 1988); *Yentsch* v. *Texaco Inc.*, 630 F.2d 46, 53 (2d Cir. 1980). A leading scholar has observed that "the absence of even an indirect threat is exculpatory, especially when the feared retaliation [as here] has never occurred." VI Philip E. Areeda, *Antitrust Law* ¶ 1408b2, at 43 (1986).

well-established case law.

2. **No Legal Basis for the "Appeasement" Theory.** The Third Circuit recognized that Stern's "motivation" to enter the alleged conspiracy was an essential link in its chain of conspiratorial inferences. It held that, as a matter of law, this "inference of motivation," 94A n.30, could be premised on the further inference that "Stern benefitted from appeasing the supplier [Armstrong] upon whom it was so dependent" for 90% of its product. 96A (emphasis added). This appeasement theory has no anticompetitive component and would irrationally provide the "motivation" for an antitrust conspiracy in thousands of normal business relationships where a distributor is closely aligned with one manufacturer's product. More importantly, *Monsanto* clearly rejected such an appeasement theory by holding that "a distributor is free to acquiesce in the manufacturer's demand" and that no vertical conspiracy is created even if such acquiescence is motivated by the distributor's desire "to avoid termination." 465 U.S. at 761.

3. **Absence of Any "Acquiescence" by Stern.** The Third Circuit likewise never addressed the *Monsanto* holding that an antitrust vertical conspiracy cannot be inferred from circumstantial evidence in the absence of proof that "the distributor communicated its acquiescence or agreement, and that this was sought by the manufacturer." 465 U.S. at 764, n.9. The record contains not even a hint or suggestion of Stern's acquiescence to Roth's comment. To the contrary, immediately after Roth's statement, Abrahamson pointed out that TINS would "fill in a void" in Armstrong's videos, whereupon Roth said nothing more about TINS and the conference turned to other matters. 189A-190A. Thus, Stern never communicated, and Armstrong never sought, Stern's acquiescence or agreement to any "common scheme" to eliminate TINS. Once again, the Third Circuit's silence on this point reflects a glaring and

unexplained departure from established law.

4. **Impermissible Vicarious Knowledge Theory.** The Third Circuit asserted *ipse dixit* that "it is not likely that Stern believed it was the only distributor Armstrong did not wish TINS to deal with."[9] Then, it ruled there could be further inferences "that Stern is *chargeable with knowledge* that if Armstrong succeeded, TINS would indeed be eliminated." 97A (emphasis added). But the established law requires a "meeting of minds" or a "conscious commitment to a common scheme." *Monsanto*, 465 U.S. at 764. As a matter of law, vicarious knowledge "chargeable" to Stern cannot suffice.[10]

5. **Absence of Evidence to Exclude the Possibility of Stern's Independent Action.** The Third Circuit failed to

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[9] This assertion as to Stern's "belief" is sheer speculation flatly contrary to the record. All of Stern's *actual* knowledge of Armstrong's position concerning other TINS distributors was *favorable* to TINS. Stern called one Armstrong distributor in the TINS program at TINS' recommendation and received favorable comment, JA4661-62. When TINS ceased operations, five of its ten sales representatives were Armstrong distributors who had sold nearly 60% of the total subscriptions to TINS' magazine. JA7962-63.

[10] The Third Circuit, after complaining that "Armstrong inexplicably cites to a conscious parallelism case," proceeded to hold: "We do not require the same checks against speculation in a vertical case as we do in a conscious parallelism case." 82A-83A, n.32. This is plainly at odds with *Monsanto*, which teaches that checks against speculation in vertical cases are of the highest order. In *First Nat'l Bank v. Cities Serv. Co.*, 391 U.S. 253, 284-86 (1986), the Court in a conscious parallelism case rejected the inference that Cities had joined a conspiracy to "boycott" plaintiff based on evidence Cities had cancelled an allegedly favorable prospective contract with plaintiff and had knowledge this would aid the other alleged conspirators to attain their unlawful objective; however, because such alleged economic interests of Cities under the prospective contract were closer to those of plaintiff as compared to interests of others in the conspiracy, and because Cities had an independent reason for its action, "neither precedent nor logic supports petitioner's contention that the evidence . . . is significantly probative of conspiracy [by Cities]." *Id.* at 288. The same reasoning requires rejection of the Third Circuit's inference of conspiracy by Stern in this case.

address the *Monsanto* requirement that "there must be evidence that tends to exclude the possibility" that Stern acted independently in cancelling the Letter of Intent. 465 U.S. at 764. But the record established, as the Third Circuit acknowledged, that Abrahamson requested an "unconditional money-back guarantee" from TINS for dissatisfied subscribers, and TINS' National Sales Manager "admitted that he made no such promise to Abrahamson directly." 42A. This obviously was a legitimate independent business reason for Stern's cancellation of the Letter of Intent. Roth's single oral comment cannot satisfy the *Monsanto* requirement of evidence that tends to exclude the possibility of Stern's independent action.

6. **Irrational Business Conduct Required by Third Circuit's Decision.** *Monsanto* holds that a vertical conspiracy cannot rest on inferences that "would create an irrational dislocation in the market," such as a conspiratorial inference derived from the manufacturer's termination of a price-cutting distributor after receipt of "complaints" from other distributors. 465 U.S. at 764. The proffered rule rejected in *Monsanto* would have encouraged a manufacturer to adopt irrational steps to squelch such communications from distributors or to erect a Chinese Wall inhibiting their receipt. *See also Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 728 (1988) (legal rules on non-price vertical restraints must not encourage "[m]anufacturers . . . to forgo legitimate and competitively useful conduct rather than risk treble damages.")

But the Third Circuit's decision, if upheld, would require irrational business conduct far more perverse than that condemned in *Monsanto* and *Business Electronics*. What should Armstrong and other manufacturers do to avoid future lawsuits like this one?

Must Armstrong prohibit local sales personnel from

stating, in words or substance, that "it makes no sense" for their customer to distribute a perceived "overlap" product? Should Armstrong curtail its sales efforts directed to distributors for whom Armstrong has succeeded, or may soon succeed, in supplying 90% of their product? For purposes of the 90% test, is it significant that the distributor sells, or does not sell, non-floor covering products such as major household appliances? Should Armstrong attempt to impose restrictive procedures to prevent its personnel from hearing, or even reading in *The Wall Street Journal*, the voluntary disclosure of another company's poor financial condition? A safe harbor under the Third Circuit's decision would require irrational conduct consistent with an affirmative answer to each of the above questions.

In sum, the Third Circuit's decision on the alleged vertical conspiracy is based on numerous sharp and unexplained departures from well-established law. It should therefore be summarily reversed. *Cf. Palmer* v. *BRG, Inc.*, 111 S. Ct. 401 (1990).

II. THE THIRD CIRCUIT'S "FUNCTIONALLY EQUIVALENT" TEST FOR PRODUCT MARKET DEFINITION CONFLICTS WITH DECISIONS OF THIS COURT AND OTHER CIRCUITS

The Third Circuit's decision is fundamentally flawed on the relevant product market purportedly restrained by the alleged conspiracy. In this case, the parties stipulated that the relevant *geographic* market for TINS' magazine was nationwide. As to the relevant *product* market, TINS alleged, and the Third Circuit agreed, that the relevant "market or submarket" included only two products: TINS' magazines that were sold for profit to retailers, plus Armstrong's video "selling aids" that were sold

on a non-profit basis only to its distributors.[11]

In upholding an alleged two-product "market or submarket," the Third Circuit relied on testimony of TINS' President (Fineman):

> [H]e opined that, with the sole exception that Armstrong's video exclusively focused upon Armstrong's products, Armstrong's and TINS' video network were *functionally equivalent* [because both] . . . provided product information and sales techniques.

55A (emphasis added). It then cited evidence indicating that distributors, without charge, "were showing [Armstrong's] videos to retailers," whereupon the court inexplicably announced that Armstrong therefore "admitted that its videos *would be sold* through distributors to retailers." 55A-56A (emphasis added). On this basis, the Third Circuit ruled: "Thus, the record supports the jury's inference that retailers may have perceived TINS' and Armstrong's videos to be interchangeable [because] [b]oth offered product information, sales training and techniques." 56A.

The Third Circuit could point to nothing in the record indicating that any retailer had such a perception or had ever actually purchased one video as a substitute for the other. Nor does the record show that a distributor (or even TINS itself) ever offered or sold one video as a substitute for the other. JA4227-29, 4861-62. To the contrary, *every* witness with personal knowledge of the use or marketing of the two videos

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[11] The Third Circuit's decision on the relevant video magazine market was made in connection with its ruling on TINS' Sherman Act Section 2 claims. 53A-56A. The court necessarily relied on the same analysis to uphold TINS' Section 1 claim.

confirmed that they were not reasonable substitutes. JA2212, 2897-98, 2909, 2913-14, 4227-29, 4864, 4891, 5077, 5184-85, 5270-71. TINS' National Sales Manager admitted that substitution made "no sense whatsoever." JA2331. The Third Circuit nonetheless ruled that the jury could have decided the market issue on the "functionally equivalent" test embodied in Fineman's testimony and that the jury "was free to disbelieve Armstrong's evidence," including the admission of TINS' National Sales Manager. 65A.[12]

Under well-established law, the threshold legal test of any product market is "reasonable interchangeability" from the viewpoint of *buyers*: "[The] market is composed of products that have reasonable interchangeability for the purposes for which they are produced — price, use and qualities considered." *United States* v. *E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956) (*Cellophane*). In 1962, the Court reaffirmed the *Cellophane* test to identify a "broad market" but then opined: "However, within this broad market, well-defined submarkets may exist which, in themselves, constitute product markets for antitrust purposes," and the Court listed seven "indicia" to identify "submarkets," none of which included a "functionally equivalent" test.[13] The Court recently stressed that market analysis in antitrust cases should be based on "actual market realities," and expressly reaffirmed the continuing validity of the

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[12] Even without TINS' admission of non-substitutability, it is firmly established that assumed "disbelief" by the jury of "discredited testimony is not considered a sufficient basis for drawing a contrary conclusion." *Bose Corp.* v. *Consumers Union*, 466 U.S. 485, 512 (1984).

[13] *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325 (1962). The Court also recognized the supplementary product-market test based on *production interchangeability*, *i.e.*, "cross-elasticity of production facilities may . . . be an important factor in defining a product market." *Id.* at 325, n.42. This test is discussed *infra*, at p. 22, in connection with the absence of any injury to competition.

buyer substitutability test: "The relevant market for antitrust purposes is determined by the choices available to Kodak equipment owners" who were buyers of the products or services in question. *Eastman Kodak Co.* v. *Image Technical Servs., Inc.*, 112 S. Ct. 2072, 2082, 2090 (1992).

The Third Circuit's decision stands in clear and direct conflict with the well-established law in *Cellophane* and *Brown Shoe*. By adopting the "functionally equivalent" test, the court of appeals placed Armstrong's and TINS' videos in the same market without regard to whether buyers could or actually did substitute one for the other. This allowed the Third Circuit to disregard such crucial factors as *price differences* ($20 each for an Armstrong cassette versus $480/$540 per annual subscription for TINS' magazine); *content differences* (Armstrong featured only its own resilient products, while TINS covered the entire industry); *frequency differences* (Armstrong's videos were unscheduled and non-recurring, whereas TINS was a monthly magazine); and *customer differences* (Armstrong provided its nine cassettes only to its own distributors who gave free viewings to retailers handling Armstrong's resilient, while TINS' magazine was sold to all retailers).[14]

The Third Circuit's "functionally equivalent" test has been expressly rejected by at least four other circuits. In *United States* v. *Archer-Daniels-Midland Co.*, 866 F2d 242, 246 (8th Cir. 1988), *cert. denied*, 493 U.S. 809 (1989) the court recognized that "sugar and HFCS [high fructose corn syrup] are functionally interchangeable for all uses for which HFCS is

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[14] To illustrate the obvious error, the "functionally equivalent" test could place plastic knives and forks in the same "market or submarket" along with sterling silver knives and forks because both serve the same function; yet by virtue of the differences in price, use and other factors, no consumer would ever perceive that the two are reasonable substitutes, as the law requires for products to be in the same market or submarket.

suitable," but the court nonetheless refused to place them in the same market because "they are not reasonably interchangeable" in light of a 10%-30% higher price for sugar resulting from a government price support program. Similarly, the Eleventh Circuit, in an opinion expressly adopting the district court's reasoning, rejected functional interchangeability as a basis for placing both natural gas and LP gas in the same market because the price for LP gas was "roughly 100% higher" than natural gas, which negated reasonable interchangeability whenever both products were actually available to buyers.[15] The Second and Sixth Circuits have also rejected the functionally equivalent test.[16] This Court should resolve the conflict by repudiating the Third Circuit's position.

III. THE THIRD CIRCUIT IGNORED THE DECISIONS OF THIS COURT AND OTHER CIRCUITS REQUIRING PROOF OF INJURY TO COMPETITION AND RELATED ANTITRUST INJURY

In a Rule of Reason case such as this one, the plaintiff must establish injury to competition, *Monsanto*, 465 U.S. at 761; *National Society of Professional Eng'rs* v. *United States*, 435 U.S. 679, 690 (1978), plus related antitrust injury to the

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[15] *Consolidated Gas Co.* v. *City Gas Co.*, 665 F. Supp. 1493, 1516-17 (S.D. Fla. 1987), *aff'd*, 880 F2d 297 (11th Cir., 1989), *vacated for rehearing in banc*, 889 F.2d 264 (11th Cir.), *panel decision reinstated and affirmed*, 912 F.2d 1262 (11th Cir. 1990), *dismissed for mootness*, 111 S. Ct. 1300 (1991).

[16] *Borden, Inc.* v. *F.T.C.*, 674 F.2d 498, 507 (6th Cir. 1982) ("similarity of the end uses of the two products" is not sufficient to place them in the same market in light of "price . . . and quality differences"); *Hayden Pub. Co.* v. *Cox Broadcasting Corp.*, 730 F.2d 64, 70-71 (2d Cir. 1984) (evidence of functional equivalence cannot be a surrogate for proof of buyers' willingness to substitute the two products).

plaintiff's own business. *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977). Indeed, the Third Circuit recognized that TINS' Section 1 Sherman Act claim "requires proof of two elements: concerted action and an unreasonable restraint of trade" (generally identified as injury to competition). But it then inexplicably stated that "[o]nly the first element concerns us here," 77A-78A, thus ignoring Armstrong's argument that the record fails to establish any injury to competition or related antitrust injury to TINS' own business. The Third Circuit's disregard of TINS' burden to establish both of these elements is flatly inconsistent with *Monsanto*, *Professional Engineers*, and *Brunswick*.

The lower court was compelled to disregard the injury-to-competition element because there was simply no evidentiary support in the record. In this case, evidence of injury to competition theoretically could occur at three levels: (1) the retailer level where subscriptions were sold to TINS' magazine; (2) the publisher level involving the operations of firms producing or capable of producing a TINS-type magazine; and (3) the distributor level where TINS solicited distributors to be sales agents of its magazine and where the only alleged restraint of trade occurred, based on Stern's decision not to sell TINS' magazine. Nothing in the record shows the requisite injury to competition at any of these levels.

At the retailer level, the Third Circuit correctly ruled, in dismissing TINS' Section 2 Sherman Act claims, that "we are left without record support to discern precisely how extensively [if at all] Armstrong has penetrated the video [magazine] market for retailers." 61A. Apart from this negative conclusion with respect to the retailer market, the Third Circuit made no other determination with respect to injury to competition at the retailer level.

At the magazine publisher level, the Third Circuit correctly ruled, in dismissing TINS' Section 2 claims, that there could be no injury to competition "even if Armstrong remains the only supplier in the relevant video market" after TINS' departure. 61A. This conclusion was required because "the record clearly proves that barriers to entry in the video market are extremely low" as demonstrated by the uncontradicted fact that "upon TINS' demise, two Armstrong distributors produced their own substitute video magazine to satisfy their retailers' full year subscription [with] . . . little capital . . . and minimal start-up time." *Id.*[17]

At the distributor level, which in fact was the only level of competition involved in Stern's decision not to distribute TINS' magazine, uncontradicted evidence conclusively negated any injury to competition. The Census Bureau reported 2,199 floor covering distributors in the United States in 1984 (JA8563), and TINS admitted that at least 450 of them were available to sell its magazine. JA1777. Of these, only 69 carried Armstrong's resilient product, and the alleged restraint was limited to just one (Stern) which sold only to retailers in the Connecticut area. By refusing to consider this data, the Third Circuit simply ignored Armstrong's contention that any restraint of Stern could not possibly have exceeded a *de minimis* effect upon competition at the distributor level.

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[17] *See, e.g., United States* v. *Columbia Steel Co.*, 334 U.S. 495, 510-11 (1948) (if "rolled steel producers can make other [rolled] products interchangeably with plates and shapes . . . injury to competition [should be measured] . . . by considering all comparable rolled products." Several courts of appeal have recognized and applied the same principle. *United States* v. *Baker Hughes, Inc.*, 908 F.2d 981, 988-89 (D.C. Cir. 1990); *Spectrofuge Corp.* v. *Beckman Instruments, Inc.*, 575 F.2d 256, 280-81 (5th Cir. 1978), *cert. denied*, 440 U.S. 939 (1979); *Twin City Sportservice, Inc.* v. *Charles O. Finley & Co.*, 512 F.2d 1264, 1271 (9th Cir. 1975). *See also In re Budd Co.*, 86 FTC 518, 571 (1975).

The Third Circuit's total disregard of these market realities stands in direct conflict with controlling decisions of this Court. In a vertical antitrust case, the "legality of arguably anticompetitive conduct should be judged primarily by its 'market impact'." *Monsanto*, 465 U.S. at 762; *Tampa Elec. Co.* v. *Nashville Coal Co.*, 365 U.S. 320, 330-34 (1961) (vertical foreclosure of less than 1% of market is *de minimis*).

The Third Circuit's ruling also directly conflicts with the decisions of other circuits. *See Great Escape Inc.* v. *Union City Body Co., Inc.*, 791 F.2d 532, 540 (7th Cir. 1986) ("[t]he principle that there is no anticompetitive effect when a buyer simply terminates one at will contract and enters into another, overrides any inference that might be drawn from [defendant's] market share"); *Havoco of America, Ltd.* v. *Shell Oil Co.*, 626 F.2d 549, 588 (7th Cir. 1980) ("loss . . . of a single contract with a single purchaser is simply not equivalent to a deleterious effect on the market"); *Dunn & Mavis, Inc.* v. *NU-Car Driveaway, Inc.*, 691 F.2d 241, 245 (6th Cir. 1982) ("Chrysler's substitution of one auto transport company for another at its Warren plant does not limit competition in any substantial sense").

With growing frequency, routine commercial disputes have spawned lawsuits, such as this one, that include parallel tort and antitrust claims based on the same business conduct.[18]

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[18] In recognition of this development, the Antitrust Section of the American Bar Association recently created a new committee responsible for keeping abreast of this area of law. Its first project was a report on this trend based on two surveys which indicated that "some form of claim labelled 'tortious interference' . . . filed along with antitrust claims" has been occurring "twice as frequently as the next most frequent" combination of tort and antitrust claims. Saferstein, *The Ascendancy of Business Tort Claims in Antitrust Practice*, 59 Antitrust L.J. 379, 385 (1991). The Committee's report concluded: "The trend of bringing state tort law claims in federal cases will undoubtedly continue." *Id.* at 387.

But federal antitrust claims should have no place in most of these lawsuits. Long ago the Court observed that the antitrust laws do "not purport to afford remedies for all torts committed by or against persons engaged in interstate commerce." *Hunt* v. *Crumboch*, 325 U.S. 821, 826 (1945).

To give force to this general principle the Court should grant the writ in this case and provide legal criteria allowing district courts, after appropriate discovery, to dismiss federal antitrust claims based on a routine commercial dispute which has no significant impact on competition. Conduct such as Roth's statement, as well as Stern's decision not to handle a new product, occurs in the course of normal business operations involving thousands of transactions each day. It should require no more than a "twinkling of an eye" for a district court to conclude that a disappointed supplier's loss of one local distributor in Connecticut, when hundreds of other distributors are available, cannot injure competition in a market stipulated to be nationwide.[19] Nor can there be any "antitrust injury" to the disappointed supplier since loss of business following routine sales talk by another supplier is the quintessence of competition. *Brunswick*, 429 U.S. at 477.

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[19] *Cf. NCAA* v. *Board of Regents*, 468 U.S. 85, 110 n.39 (1984) (commending a "twinkling of an eye" analysis where the competitive effect of the business practice is clear on its face, *quoting* P. Areeda, The "Rule of Reason" in Antitrust Analysis 37-38 (Fed. Judicial Center, June 1981)).

CONCLUSION

The Court should grant the writ and summarily reverse with respect to the vertical conspiracy question presented. Alternatively, the Court should grant the writ with respect to all three questions and set the case for briefing and oral argument.

Respectfully submitted,

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